



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	04/04/01	Bill No:	AB 811
Tax:	Sales and Use	Author:	Zettel
Board Position:		Related Bills:	AB 646 (Horton)

BILL SUMMARY

This bill would, among other things, broaden the exemption for prescription medicines by specifying that, for the period January 1, 2002 to January 1, 2007, “medicines” includes, among other things, auditory, prosthetic, ophthalmic, ocular devices and appliances, and articles that are in the nature of splints, bandages, pads, and mechanical, electronic, optical or physical equipment or article when furnished by a health facility for the treatment of patients pursuant to a physician’s, surgeon’s, dentist’s, or podiatrist’s order.

ANALYSIS

Current Law

Under existing law, sales or use tax applies to all sales or purchases of tangible personal property, unless otherwise exempted or excluded from the computation of sales or use tax. Section 6369 of the Sales and Use Tax Law provides an exemption from tax for the sale and use of medicines sold to a licensed physician and surgeon, podiatrist, dentist, or health facility for the treatment of a human being. “Medicines” are defined in Section 6369 to include any substance or preparation intended for use by external or internal application to the human body in the diagnosis, cure, mitigation, treatment, or prevention of disease. Section 6369 specifically *excludes* from the term “medicine” items such as auditory, prosthetic, ophthalmic, or ocular device or appliance, and articles that are in the nature of splints, bandages, pads, compresses and similar items. Therefore, when a hospital purchases these items, the hospital is required to pay tax on its purchase price, or, if it makes a separate charge to patients for any of these items furnished in connection with their services, the hospital may purchase the items without payment of the tax, but is required to report the tax on the amount charged to the patient.

“Health facility” is defined within this statute by a cross-reference to Section 1250 of the Health and Safety Code. Section 1250 provides a comprehensive description of the types of establishments that fall under that term, including hospitals, skilled nursing facilities, psychiatric facilities, and others. However, outpatient clinics – which basically provide care to patients who remain less than 24 hours - do not fall within this comprehensive description. Consequently, sales of medicines to outpatient clinics for

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the treatment of a human being are subject to tax to the same extent as any other sale of tangible personal property.

Existing law defines outpatient clinics under Section 1200 of the Health and Safety Code. This section provides that "clinic" means an organized outpatient health facility which provides direct medical, surgical, dental, optometric, or podiatric advice, services, or treatment to patients who remain less than 24 hours, and which may also provide diagnostic or therapeutic services to patients in the home as an incident to care provided at the clinic facility.

Proposed Law

This bill would do the following:

- Amend Section 1250 of the Health and Safety Code to modify the definition of "health facility" by eliminating the requirement that the patients be admitted and cared for during a period of at least 24 hours.
- Amend Section 6369 of the Sales and Use Tax Law to expand the definition of medicines for calendar years 2002 through 2006, to include within that term such items as auditory, prosthetic, ophthalmic, and ocular devices, appliances, splints, bandages, compresses and similar items, and alcoholic beverages, as specified.

The bill would become operative on the first day of the calendar quarter commencing more than 90 days from the date the bill is enacted.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by Sharp HealthCare, a nonprofit San Diego-based health care organization comprised of acute care hospitals, specialty hospitals, medical groups, medical clinics, urgent care centers, skilled nursing facilities and a variety of other community health education programs and related services. Its purpose is to provide a sales and use tax exemption for purchases of "non-implanted" devices furnished by nonprofit hospitals for the treatment of patients.
2. **The language of the bill would also apply to for-profit organizations.** The bill would extend the exemption for sales of "nonimplanted" devices to for-profit hospitals and health facilities in addition to nonprofit hospitals and health facilities. Also, it appears the language attempts to additionally include clinics' purchases of both implanted and nonimplanted medicines and devices within the proposed exemption, as evidenced by the proposed changes to the Health and Safety Code. Board staff is willing to work with the author's office in drafting amendments that would reflect the author's intent.

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3. **How broad is the proposed exemption intended on being?** As currently drafted, the items specifically identified to be included within the proposed exemption would include, among other things, devices, instruments, apparatus, contrivances, electronic and other physical equipment when furnished by a health facility for the treatment of patients. This language could be interpreted to mean that items such as blood pressure monitors, exercise weights, pillows, thermometers, and even hospital beds could be included within the exemption, since all these items could be regarded as “furnished” by the health facility for the treatment of a patient. Is this the author’s intent?
4. **Technical amendments would be necessary.** Further changes to the bill would be necessary to eliminate conflicting provisions within the statute; as for example, paragraph (4) in subdivision (c) specifically excludes from the term, “medicine” auditory, ophthalmic, and ocular devices and appliances. This conflicts with the amendments proposed to subdivision (b) in the bill which appear to include these items within the “medicine” definition. Other conflicts are contained in paragraphs (2) and (3)(A) of subdivision (c), and subdivisions (f) and (g).
5. **Related legislation.** The Board is sponsoring AB 646 (Horton) to specify that sales of medicines to clinics, as defined, for the treatment of any person pursuant to the order of a licensed physician and surgeon, dentist, and podiatrist, are exempt from sales and use tax. It appears AB 811, in part, is attempting to achieve the same outcome. The author may wish to add double-joining language in this measure as both bills progress in the session, and may also wish to include similar amendments to Section 6369 that are contained in AB 646.

COST ESTIMATE

Administrative costs would include providing notices to affected retailers, auditing claimed exemptions, and amending the Board’s regulation. These costs are expected to be absorbable.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

Based on discussions with medical supply distributors and not-for-profit hospital groups in California, it is estimated that overall sales of medical supplies to not-for-profit health facilities, as defined, amounts to \$860 million.

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Revenue Summary

The annual revenue loss from exempting medical supplies, as defined, from the sales and use tax would be as follows:

	<u>Revenue Loss</u> <u>(in millions)</u>
State *	\$ 43.0
Local (2.25%)	19.4
Special District (0.67%)	<u>5.8</u>
Total	<u>\$ 68.2</u>

* The state sales and use tax rate will be 4.75% for calendar year 2001 and is scheduled to be 5% in calendar year 2002.

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